

## Message Text

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ACTION AF-10

INFO OCT-01 EUR-12 ISO-00 IO-14 AID-05 CIAE-00 COME-00

EB-08 FRB-01 INR-10 NSAE-00 USIA-15 TRSE-00

XMB-04 OPIC-06 SP-02 LAB-04 SIL-01 OMB-01 NSC-05

SS-15 STR-07 CEA-01 MMO-04 /126 W

-----061742 311816Z /64

R 311600Z MAR 78

FM AMEMBASSY PRETORIA

TO SECSTATE WASHDC 859

INFO AMCONSUL CAPE TOWN

AMCONSUL DURBAN

AMEMBASSY GABORONE

AMCONSUL JOHANNESBURG

AMEMBASSY LONDON

AMEMBASSY MASERU

AMEMBASSY MBABANE

UNCLAS SECTION 1 OF 2 PRETORIA 1812

CAPE TOWN ALSO FOR EMBASSY

E.O. 11652: N/A

TAGS: EFIN, ECON, ECRP

SUBJECT: SOUTH AFRICAN BUDGET FOR FY 78/79

1. SUMMARY: ANNOUNCING A SHIFT TO A FISCAL POLICY OF " GROWTH WITH FINANCIAL DISCIPLINE", MINISTER OF FINANCE HORWOOD PRESENTED A MILDLY EXPANSIONARY BUDGET FOR FY78/79 WHICH UTILIZES A 10 0/0 PERSONAL INCOME TAX CUT AS ITS MAIN STIMULATORY PROVISION. IN A COMPLEX BUDGET WITH MUCH GIVE AND TAKE, INCOME TAX CUT WAS PARTIALLY OFFSET BY INTRODUCTION OF A 4 0/0 RETAIL SALES TAX. THE OVERALL RESULT OF THESE TWO MEASURES IS A SHIFT IN EMPHASIS FROM DIRECT TO INDIRECT TAXATION. LOWER INCOME GROUPS,

PARTICULARLY BLACKS, WILL BEAR A PROPORTIONATELY HEAVIER SHARE OF THE  
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NEW TAXATION ALTHOUGH SOME RELIEF WAS PROVIDED IN FORM OF ELIMINATION OF THE "HEAD" TAX ON BLACKS AND A MODEST FUND TO STABILIZE FOOD PRICES. IN FOCUSING TAX CONCESSIONS ON MIDDLE TO UPPER INCOME CONSUMERS, BUDGET GIVES IMPLICIT RECOGNITION TO FACT LOW LEVEL OF CONFIDENCE AND SPENDING AMONG THESE GROUPS HAS BEEN A KEY FACTOR IN CONTINUATION OF RECESSION. WITH THE FLOW OF FOREIGN CAPITAL DRIED UP AND INDUSTRY OPERATING WELL BELOW CAPACITY,

THESE CONSUMERS REPRESENT ONLY POTENTIALLY EXPANSIONARY FORCE IN PRIVATE SECOTR. ACTUAL NEW MONEY PUMPED INTO THE SYSTEM BY THE BUDGET IS LIMITED BUT PSYCHOLOGICAL BOOST MAY BE ENOUGH TO NUDGE ECONOMY UPWARD. BUDGET WAS GENERALLY WELL RECEIVED IN BUSINESS CIRCLES ALTHOUGH BLACK LEADERS AND OPPOSITION STRESSED BURDEN ON LOWER INCOME GROUPS. SPECIFIC ELEMENTS IN BUDGET INCLUDE MODEST 9 0/0 INCREASE IN OVERALL SPENDING FOCUSED PRIMARILY ON EDUCATIONS, HOUSING, AND SOCIAL WELFARE. DEFENSE APPROPRIATION SHOWS A SURPRISING R100 MILLION DECLINE. WITH RETAIL SALES TAX DUE TO COME INTO EFFECT ON JULY 1, EXISTING SELECTIVE SALES DUTIES WERE CUT 5 0/0 BUT THEIR COMPLETE PHASE-OUT WAS LEFT UNCERTAIN. LEVEL OF IMPORT SURCHARGE ALSO CUT TO 12.5 0/0 AND HORWOOD GAVE HOPE, BUT NO COMMITMENT, OF FURTHER REDUCTIONS LATER ON. REPATRIATION OF CAPITAL WAS TIGHTENED UP BY RESTRICTING REMITTANCES OF EARNINGS ON SECURITIES RAN TO NEW 6 0/0 GOVERNMENT BONDS. END SUMMARY.

2. ECONOMY IN 1977- PREFACING BUDGET BY SUMMARY OF ECONOMIC MOVEMENTS IN 1977, HORWOOD REPORTED CURRENT ACCOUNT SURPLUS OF R759 MILLION WAS ACHIEVED COMPARED TO DEFICIT OF R1,630 MILLION IN 1976.

HOWEVER, CURRENT ACCOUNT SURPLUS AND SMALL INFLOW OF LONG-TERM CAPITAL OFFSET BY R1,086 MILLION OUTFLOWS OF SHORT-TERM CAPITAL. RESULT WAS DECLINE OF R124 MILLION IN NET FOREIGN RESERVES IN 1977. ONLY POSITIVE ELEMENT HERE WAS FACT MOST OF DECLINE OCCURRED IN FIRST QUARTER AND FINAL QUARTER SAY R59 MILLION UNCLASSIFIED

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INCREASE. ON OVERALL ECONOMIC PERFORMANCE, HORWOOD PRESENTED GRIM PICTURE WITH REAL GDP GROWING BY ONLY ONE-HALF PERCENT IN 1977, LOWEST GROWTH RATE SINCE 1930'S. REAL GNP DID SLIGHTLY BETTER AT 1 0/0. REAL GROSS DOMESTIC EXPENDITURES DECLINED BY 5 0/0 SIGNIFICANTLY MORE THAN INCOMES REFLECTING LOW LEVEL OF BUSINESS AND CONSUMER CONFIDENCE.

3. REPORT ON FY77/78 - ON FISCAL YEAR ENDING MARCH 31, 1978, HORWOOD REPORTED EXPENDITURES WERE R110 MILLION BELOW PROJECTIONS. REVENUE WAS ALSO DOWN BY R167 MILLION BUT TREASURY LOANS PRODUCED MORE THAN EXPECTED ON DOMESTIC MARKET. RESULT WAS THAT SAG ENDS YEAR WITH SURPLUS OF R77 MILLION AFTER COVERING DEFICIT OF R53 MILLION ON SOUTH AFRICA ACCOUNT.

4. FY 78/79 BUDGET EXPENDITURE- FOR UPCOMING YEAR, HORWOOD PROJECTS EXPENDITURE OF R9,811 MILLION, 9 0/0 ABOVE PREVIOUS YEAR. HOUSING WILL GO UP 16 0/0 TO R177 MILLION PLUS SPECIAL R80 MILLION FUND FOR NON-WHITE HOUSING ANNOUNCED IN NOVEMBER. NATIONAL ( WHITE) EDUCATION INCREASES BY 7 0/0 TO R303 MILLION, WHILE BLACK EDUCATION INCREASES BY 22 0/0 TO R144 MILLION.

HOWEVER, SOME OF THIS INCREASE FOR BLACK EDUCATION REPRESENTS SHIFT FROM OTHER BUDGET ITEMS. PENSIONS AND SOCIAL WELFARE RECEIVED HEFTY BOOS OF R56 MILLION ( 13 0/0) PARTIALLY TO COMPENSATE FOR NEW RETAIL SALES TAX. MOST SURPRISING ASPECT OF ENTIRE BUDGET WAS CUT IN PROJECTED DEFENSE SPENDING OF R100 MILLION TO R1,554 MILLION. EVEN WHEN R128 MILLION CREDIT FROM UNDERLIVERED FOREIGN PURCHASES ARISING FROM ARMS EMBARGO IN FY 77/78 IS COUNTED, DEFENSE SPENDING PROJECTED TO UNDERGO DECLINE OF NEARLY 10 0/0 IN REAL TERMS. HORWOOD EXPLAINED THIS BY STATING THAT AFTER INCREASES OF 235 0/0 IN PREVIOUS FOUR YEARS, PERIOD OF CONSOLIDATION NOW NEEDED.

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HE ADDED THAT STRNG OVERALL ECONOMY IS STRONGEST DEFENSE COUNTRY CAN HAVE. INCREASE OF 9 0/0 IN VOERALL BUDGET EXPENDITURE IS SLIGHTLY ABOVE FY 77/78 INCREASE BUT STILL BELOW 11 0/0 INFLATION RATE.

WITH MOST OF GROWTH OCCURRING IN DOMESTIC SOCIAL PROGRAMS AND NONE IN DEFENSE, EXPANSIONARY EFFECT ON DOMESTIC INCOMES WILL BE SLIGHTLY MORE THAN 9 0/0 FIGURE SHOWS. NEVERTHELESS, GOVERNMENT SPENDING ITSELF IS NOT PROJECTED TO BE A SIGNIFICANT STIMULUS TO ECONOMIC GROWTH.

5. TAXATION MEASURES- HORWOOD ANNOUNCED THAT PERSONAL INCOME

TAXES WERE BEING REDUCED BY 10 0/0. COMPANIES TAX CUT BY 2.5 0/0.  
IN ADDITION, REPAYMENT TO BOTH INDIVIDUAL AND COMPANIES OF PREVIOUS  
LOAN LEVY DUE FEBRUARY 1979 IS BEING ADVANCED TO JULY THIS YEAR.  
EFFECT OF PERSONAL INCOME TAX CUT FOR MARRIED TAXPAYER WITH  
TWO CHILDREN WILL BE SAVING OF R27 AT INCOME OF R5,000; R 116 AT  
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R10,000; AND R472 AT 420,000. MAXIMUM MARGINAL TAX RATE FALLS TO  
50 0/0. PARTIALLY COUNTERACTING EFFECT OF INCOME TAX CUT WAS  
ANNOUNCEMENT THAT LONG EXPECTED RETAIL SALES TAX WOULD COME INTO  
EFFECT JULY 1, 1978 AT LEVEL OF 4 0/0. VIRTUALLY ALL GOODS NOT  
INTENDED FOR RESALE OR USE IN FURTHER MANUFACTURING PROCESS WILL BE  
SUBJECT TO TAX, FINAL DETAILS OF WHICH ARE STILL BEING WORKED OUT.  
REQUIREMENTS FOR AGRICULTURAL PRODUCTION GENERALLY EXEMPT. TO  
PARTIALLY OFFSET EFFECT OF SALES TAX ON LOWER INCOME GROUPS, R2.50  
GENERAL ( HEAD) TAX ON BLACK MALES BEING ABOLISHED. IN ADDITION, R20  
MILLION BEING APPROPRIATED TO STABILISE PRICE OF BREAD AND CERTAIN  
OTHER STAPLES. OTHER CHANGES INCLUDE REDUCTION OF CURRENT SALES  
DUTIES BY 50 0/0. THERE WAS SOME EXPECTATION THAT MOST OF THE SALES  
DUTIES WILL BE EVENTUALLY PHASED-OUT BUT HORWOOD GAVE NO DETAILS  
REGARDING THIS. THE 15 0/0 IMPORT SURCHARGE IMPOSED IN LAST  
YEAR'S BUDGET WAS CUT TO 12.5 0/0 HE STATED HOWEVER THAT IT WAS STILL

HIS INTENTION " TO REDUCE THE SURCHARGE FURTHER AND POSSIBLY TO PHASE  
IT OUT AS AND WHEN FISCAL CIRCUMSTANCES PERMIT." IN ADDITION TO  
HOST OF OTHER LESS IMPORTANT TAXATION CHANGES,  
HORWOOD ANNOUNCED THAT TO CHECK EXCESSIVE PROFITS EARNED  
BY FOREIGN INVESTORS REDEMPTION PROCEEDS FROM GOVERNMENT  
BONDS PURCHASED WITH SECURITIES RAND WILL HENCEFORTH NOT BE FREELY  
TRANSFERABLE ABROAD. INSTEAD REPATRIATION OF PROCEEDS WILL ONLY BE  
PERMITTED FROM SPECIAL 6 0/0 SECURITIES RAND BONDS WHICH WILL BE  
NON-TRANSFERABLE AND HAVE A MATURITY OF 7 YEARS. THIS DOES NOT AFFECT  
EXISTING HOLDERS OF BONDS AND STOCKS PURCHASED WITH  
SECURITIES RAND.

6. COMMENT: GOAL OF BUDGET IS CLEARLY A RESTORATION OF BUSINESS  
AND CONSUMER CONFIDENCE WITHOUT ENDANGERING BALANCE OF  
PAYMENTS BY LARGE INCREASES IN REAL GOVERNMENT SPENDING. HORWOOD  
ATTEMPTS TO ACHIEVE THIS PRIMARILY THROUGH A MIXTURE OF GIVE AND TAKE  
ON TAXES WHICH PRODUCES A SHIFT FROM DIRECT TOWARD INDIRECT  
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TAXATION, AND A REDUCTION IN COMPARATIVELY HIGH MARGINAL RATES  
OF INCOME TAX ( 70 0/0 OVER R30,000). GROUP WHICH BENEFITS MOST FROM  
THIS APPROACH WILL BE MIDDLE AND UPPER INCOME CONSUMERS WHOSE LOW  
LEVEL OF CONFIDENCE HAS CAUSED CONSUMER SPENDING TO FALL FASTER THAN

REAL INCOMES THUS PROLONGING RECESSION. ASSUMING MAJOR NEW  
POLITICAL SHOCKS ACAN BE AVOIDED, HORWOOD'S BUDGET IS BASED ON HOPE  
OF GETTING THESE GROUPS SPENDING AGAIN AND AT LEAST NUDGING  
ECONOMIC GROWTH ABOVE 2 0/0. COSTS OF THIS STRATEGY ARE IN  
INCREASED TAXATION FOR LOWER INCOME GROUPS OF ALL RACES,  
ESPECIALLY BLACKS, WHICH ARE ONLY PARTIALLY OFFSET BY OTHER  
TAX CONCESSIONS. HORWOOD CLAIMED THAT REAL WHITE WAGES  
DECLINED BY 3.4 0/00 IN 1977 WHILE REAL WAGES OF NON-WHITE  
GROUPS CONTINED TO RISE, WHICH MAY BE PART OF REASONING  
UNDERLYING CHOICE OF FISCAL STRATEGIES.  
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## Message Attributes

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